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BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO 35081

CANADIAN PACIFIC RAILWAY COMPANY, ET AL
– CONTROL –
DAKOTA, MINNESOTA & EASTERN RAILROAD CORP, ET AL

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REBUTTAL IN SUPPORT OF REQUEST FOR CONDITIONS
BY ARKANSAS ELECTRIC COOPERATIVE CORPORATION

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THE
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REBUTTAL IN SUPPORT OF REQUEST FOR CONDITIONS BY ARKANSAS ELECTRIC COOPERATIVE CORPORATION

I INTRODUCTION

Arkansas Electric Cooperative Corporation (AECC) submits this rebuttal in support of its request for conditions to be imposed on the proposed control by Canadian Pacific Railway Company, et al (CP) of the Dakota, Minnesota & Eastern Railroad Corporation, et al (DME) (jointly, Applicants) 1/ This rebuttal responds to Applicants' arguments in response to AECC's opposition evidence and argument and request for conditions (see Applicants' Response To Comments And Requests For Conditions And Rebuttal In Support Of Application (CPR-14 DME-14, dated April 18, 2008) ("Applicants' Response"), Volume 1 at pages 39-44)

The five pages that Applicants devote to AECC's evidence, argument, and conditions are utterly lacking in evidentiary support Applicants cite no witness or other relevant evidence to address any of the concerns that AECC identified regarding the likely effects of the proposed transaction on DME's planned construction project to reach the Powder River Basin (PRB) (hereafter, "Project") or other prospective PRB access

1/ AECC and its interests in this proceeding were described in Opposition Evidence And Argument And Request For Conditions Of Arkansas Electric Cooperative Corporation (AECC-3, dated Mar 4, 2008) ("AECC's Opposition") initiatives Unburdened by facts, it wanders through a series of unsubstantiated assertions that do not withstand scrutiny.

Yet the concerns that AECC raised – regarding the effects of CP's cooperative business relationships with UP and BNSF and of up to a billion or more dollars of contingent payments on the likelihood that the Project would be built – are matters about which Applicants should be readily able to present responsive evidence, if indeed any response to these concerns is possible Even without examining any of the details, the failure of Applicants to offer a substantive response to AECC's concerns demonstrates the validity of these concerns

In this Rebuttal, we respond to the Applicants' arguments as follows

A Applicants are wrong that building the extension into the PRB is not important to the public interest

B CP acquisition of DME would not enhance the prospects that the PRB Project will be built

C. CP's interdependence with UP and BNSF would discourage CP from building the Project in order to compete with UP and BNSF for PRB coal business

D The contingent payments required under the Agreement and Plan of Merger would act as a "poison pill" to prevent construction of the Project

E The conditions proposed by AECC to prevent anticompetitive effects of this transaction are reasonable and well within the Board's powers.

II DISCUSSION

A <u>Building The DME Powder River Basin Project Would Serve The Public Interest.</u>

AECC's Opposition demonstrated that CP's acquisition of DME would make the construction of the Project less likely than it would be absent the merger, both because of the huge contingent fee payments required under the Agreement and Plan of Merger, and because CP would have to weigh the loss of substantial business it now does with UP and BNSF against whatever gains it might associate with the PRB coal business if it built the Project to compete with UP and BNSF

Applicants' first response is to argue that the Project may never be built anyway, because DME has spent a decade trying to develop commitments from shippers and financiers, so far without success, and if the PRB Project is never built, that should be of no concern to the Board, say Applicants, because it "would not lead to a <u>reduction</u> in competition – rather it would maintain the competitive status quo in the PRB " Applicants' Response at page 41 This is a remarkable argument Contrary to Applicants' claim that AECC is trying to relitigate the Board's approval of the PRB Project by raising issues about its viability (<u>id</u>), it is <u>Applicants</u> in fact who are now "questioning the financial viability of the PRB Project" and arguing that it therefore does not matter whether the Project is built or not

As the Board is well aware, its approval of DME's application for authority to construct the Project found that the Project had the potential to produce a broad range of substantial public and private benefits in comparison to the status quo without the Project The Board held that

> The public interest would be well served by the construction project due to the potential for increased competition for PRB coal

> to meet increased energy demand, lower costs (due to DM&E's geographic advantage to certain generation facilities in the midwest), *and improved service to DM&E's existing shippers*

Dakota, Minnesota & Eastern R R Construction into the Powder River Basin, STB Fin Dkt 33407, served Feb 15, 2006, at 17, 2006 WL 383507, at *13 (S T B Feb. 13, 2006)

Must those benefits of the Project be ignored because they are, at this time, potential rather than current? Of course not The Board frequently considers the effect of proposed transactions on potential competition as well as actual current competition

Several examples can be cited in a single case, the UP/SP merger proceeding In that case, the operators of the White Bluff Steam Electric Station near Redfield, AR, argued that the merger would eliminate potential competition, even though the plant at the time was served only by UP The reason was that the merger as proposed would eliminate the possibility of "a build-out to a nearby SP line, located about 21 miles away at Pine Bluff, [which] would enable White Bluff to enjoy a BNSF-SP routing . " The Board did not rule, as Applicants here apparently think it should have, that this loss of potential competition was of no concern because it would "maintain the competitive status quo" On the contrary, the Board granted the build-out relief requested See Union Pacific Corp , et al – Control and Merger – Southern Pacific Rail Corp , et al , 1 S T B 233, 303 (1996), aff'd sub nom Western Coal Traffic League v STB, 169 F 3d 775 (D C Cir 1999) ("UP/SP Merger")

Union Carbide Corporation made a similar argument in the same case with respect to potential competition at its Seadrift, TX plant, which was solely served by UP, but where the potential for a build-out to SP acted as a constraint on UP's exercise of market power The Board did not respond that there was no cause for concern because the merger would "maintain the competitive status quo" Rather, the Board conditioned the UP/SP merger on trackage rights to BNSF to "preserve[ ] the build-out status quo" – that is, the status quo in which there was a potential for competition even where none now existed UP/SP Merger, at 475 See, also, Burlington Northern & Santa Fe Ry – Construction and Operation Exemption – Seadrift and Kamey, TX, STB Fin Dkt 34003, served June 19, 2001, at 1-2, 2001 WL 684312, at *1 (S T B June 12, 2001) In San Jacinto Rail Limited Construction Exemption, et al – Build-Out To the Bayport Loop, STB Fin Dkt 34079, served July 9, 2003, at 3-4, 2003 WL 21542058, at *2 (S T B July 9, 2003), the Board approved another build-out to fulfill a condition imposed in the UP/SP merger to "preserve[ ] the potential for the creation of competitive rail service . "

In evaluating the competitive effects of mergers and other transactions, the Board frequently considers potential competition as well as actual current competition See, e.g , Review of Rail Access and Competition Issues – Renewed Petition of Western Coal Traffic League, STB Fin Dkt 575, served Oct 30, 2007, at 9-10, 2007 WL 3170981, at *6 (S T B Oct 29, 2007) (potential for short lines to expand into other markets and add to competition), Norfolk Southern Corp , et al – Control and Consolidation Exemption – Algers, Winslow & Western Ry , STB Fin Dkt 34839, served Feb 15, 2007, at 11-12, Fed Carr Cas P 37229, 2007 WL 482682, at *8 (S T B Feb 13, 2007) (trucks and barges as competitive alternatives to rail service), Canadian National Ry , et al – Control – Duluth, Missabe & Iron Range Ry , et al , STB Fin Dkt 34424, served April 9, 2004, at 17-18, Fed. Carr. Cas. P 37139, 2004 WL 761305, at *13

(S T B Apr 9, 2004) (describing build-in/build-out options and transload options as "potential competitive options")

Improving the status quo is one of the core features and benefits of a competitive marketplace The existence of benefits associated with the entry of new competitors may be a foreign concept to a duopolist/oligopolist like CP, but it is a central tenet of the U.S. national transportation policy The Board's interpretation of its mandate under the ICC Termination Act of 1995 affirms that undue impedance of a pro-competitive new construction project can be presumed to be contrary to the public interest

Therefore, Applicants are plainly wrong in arguing that the Board should ignore the adverse effect that this transaction would have on potential competition in the PRB

Because Applicants imply that AECC is trying to relitigate the Board's approval of the DME Project, as AECC purportedly tried to do "in prior cases", Applicants' Response at pages 41-42, citing Dakota, Minnesota & Eastern R R – Control – Iowa, Chicago & Eastern R R , 6 S.T B 511, 525-26 (2003) ("DM&E/IC&E"), we will underscore a point we thought we had made clearly in AECC's Opposition AECC is not arguing in this case that the Board "erred" when it authorized DME to build the PRB Project AECC assumes in its argument in this case that the Board's decision was correct when it approved the Project, and that significant public benefits would be generated as a result of that Project 2/ AECC urges in this case that the Board not gut those benefits by

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2/ Of course, the Board could revisit its approval of the DME Project in an appropriate case, but this proceeding clearly is not such a case For example, in Tongue River Railroad Company, Inc —Construction And Operation—Western Alignment, STB approving CP's acquisition of DME without appropriate conditions The conditions that AECC proposes would rectify the adverse impacts on the Project that would be caused by the proposed merger, and would protect the public interest in the event that CP elects not to proceed with the Project AECC's proposed conditions would in no way interfere with the opportunity CP asserts it needs to assess the Project, nor with CP's ability to proceed with the Project if it decides to do so

It is Applicants, not AECC, that are arguing that the Project may not be viable after all and that the Board therefore need not be concerned if the CP acquisition of DME scuttles it As long as DME holds authority from this Board to construct the Project, the Board should reject that argument

B CP Acquisition Of DME Would Not Enhance The Prospects That The Project Would Be Built

In AECC's Opposition, AECC showed specific reasons why CP's acquisition of DME would have detrimental effects on the viability of the Project In response to these arguments, Applicants assert that CP's "greater financial capability, its demonstrated expertise in designing and constructing new rail lines, and its extensive coal hauling experience will enhance – not detract from – DM&E's ongoing efforts to bring the PRB Project to fruition " Applicants' Response at page 41

Applicants have submitted not a shred of evidence to support these assertions about CP's potential contributions to the Project The Board requires evidence, not puffery, in proceedings of this kind

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Fin Dkt 30186 (Sub-No 3), served March 12, 2008, at pages 5-6, the Board observed that it may be appropriate to reconsider construction authority granted under the standards of the ICCTA of 1995 where new evidence or evidence of changed circumstances raises doubts about an applicant's financial fitness

With respect to CP's vaunted "financial capability", this is unlikely to be of great use in undertaking the Project, in light of the fact that the financial community has threatened CP's credit with a downgrade to "junk bond" status if it undertakes the Project 3/

As for coal-hauling experience, DME has at least as much relevant experience as CP does DME/ICE already handles volume movements of PRB coal (to plants served by ICE), and through such operations and Project planning is thoroughly versed in the infrastructure and operating issues associated with PRB coal movements In contrast, CP has divested its ability to originate U S coal, 4/ and there is no reason to believe that its other coal-moving experiences will provide guidance more useful than that DME has already obtained.

CP's most recent significant experience in "building new rail lines" apparently occurred in the 1980's, including work on its Elk River line and relocations of its western main line (including the 9.8-mile Mount Macdonald Tunnel) to reduce the ruling grade against westbound loads to 1 percent 5/ With all due respect for the

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3/ A representative of Moody's Investment Services has indicated that the acquisition of DME will place downward pressure on CP's credit ratings, but that CP will remain investment grade as long as the PRB expansion project is not undertaken This is echoed by a representative of UBS Investment Research, who has highlighted the remote probability that the economics of the expansion project would be favorable Originally reported at www canadacast com/rss/article/66461 , now archived at www dmetraintruth com/pdf/headache_9 5 pdf

4/ In a decision served April 11, 2006 in STB Finance Docket No 34783, Indiana Railroad Company – Acquisition -- Soo Line Railroad Company, the Board authorized CP's divestiture to Indiana Railroad (INRD) of the entirety of its operations between Chicago and Louisville, KY This line formerly enabled CP to originate coal from mines in western Indiana

5/ The only "new rail line" referenced in the most recent Corporate Profile and Fact Book (2006) available from CP's website is the Mount Macdonald Tunnel, which also engineering and management skills required to complete that work, it has been 20 years or more since the work was performed, and most or all of the senior CP personnel involved in that work have presumably retired or moved to other employment by now Furthermore, DME has spent over 10 years on the planning and development of the Project If CP takes over DME, it would use the same types of engineering and construction contractors to undertake the Project as would DME There's no reason to expect that the involvement of CP would materially change DME's ability to execute construction of the Project as designed and approved

To the extent that current CP management <u>does</u> have expertise that might help the Project, the structure of the proposed transaction undermines the ability of the Project to benefit from such expertise. For example, suppose hypothetically that CP's "expertise in designing and constructing new rail lines" led it to conclude that the Project could be improved by changing the approved alignment to allow tolerance of greater curvature in the design of the new line, which could produce substantial savings in earthwork costs in the hilly terrain that typifies much of the Project route <u>6</u>/ Or suppose hypothetically that CP concluded that expansion of the ethanol market creates an

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entailed significant relocations of track outside the tunnel to produce the reduction of ruling grades against westbound loads to 1 percent See CP's <u>2006 Corporate Profile and Fact Book</u> at www8 cpr.ca/cms/NR/rdonlyres/cpcwub5tmdw5ishzrtlbcvuitabzchn3uh hmsq3pecx63gh2t4atp5b4cdlzbovubvvr6pbcobvgqveq7gkn5ssk4xa/Assets pdf The only other significant rail capacity investment cited in this source is $160 million spent to *increase achievable throughput (by 4 trains per day) within* CP's established western corridor route This investment is not known to have involved construction of any "new rail lines", [redacted] See CPR-14 DME-14 (Highly Confidential), Volume 2, <u>Appendix O</u> at page O-3, and Section II C , below.

<u>6</u>/ It is understood that the new lines CP constructed in the 1980's were designed and built with substantially higher levels of curvature in comparison with the design of the Project

opportunity for the Project to make use of CP's line to Sheldon, IA in place of the existing DME main line As the Board is well aware, for example from the Tongue River Railroad cases, changes of circumstance and new information may materially alter the preferred alignment for a rail construction project However, even if CP concludes that the approved alignment is undesirable, and obtains its own authority for a different alignment, it would still have to make the same contingent fee payments as it would if it adhered to the approved DME alignment, because the Agreement and Plan of Merger provides that "New Construction" includes any "modified" line extension and thus would trigger the contingent payment Agreement and Plan of Merger (Exh 2, CPR-2 DME-2) at page 9 Thus, any contribution that CP might be able to make to the success of the Project, along with DME's Board-granted authority, would be held for ransom by the British venture capitalists 7/ who hold the contingent payment claims.

Applicants do not even claim, much less prove, that CP's involvement in the proposed transaction would meaningfully enhance the economic viability of the Project. This is not surprising, given that in the primary DME service area there is only one (1) PRB coal-burning powerplant that is exclusively-served by CP (i e , for which CP could effectively ensure movement from the PRB via the Project) If CP had any resources that would benefit the Project, it has had 10 years to form a joint venture with DME to exploit such resources without exposing the Project to the major contingency payments that are now threatened

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7/ Press reports indicate that slightly over 10 percent of current and prospective future DME sale proceeds go to U S -based rail product supplier L B Foster, with the remainder going to London-based Electra Private Equity See www railwayage com/breaking_news_archive shtml (Sept. 6, 2007)

C CP's Interdependence With UP And BNSF Makes CP Less Likely To Build The Project

In AECC's Opposition, we pointed out that CP's existing cooperative relationships with UP and BNSF might make CP less interested in competing vigorously with UP and BNSF for PRB coal traffic than DME would be as an independent railroad AECC's Opposition at pages 7-8 Applicants call this concern "nonsense" Applicants' Opposition at page 42. Presumably Applicants think that Canadian National CEO E. Hunter Harrison was also talking nonsense when he likened the response of UP and BNSF to a new entrant into the PRB to a "meeting in the alley"

It is not "nonsense", it is common sense, before a railroad commits itself to a multi-billion-dollar expansion into a new market, to consider the effect of that expansion on its existing business relationships

Applicants also call the concern AECC raised "unsupported and unfounded speculation" Applicants' Response at page 42 As AECC observed in its Opposition at page7, footnote 6, in discovery CP's marketing witness was unable to supply any quantitative information about how much traffic CP interchanges with UP and BNSF, so to that extent AECC was unable to quantify its concern Obviously, CP is in a position to know this information, and AECC is not, if quantitative information about CP's relationships with UP and BNSF could relieve the concern that these relationships would inhibit CP entry into the PRB, CP should be able to provide that information to the Board.

Yet it is Applicants' response, not AECC's concern, that is "unsupported and unfounded" by any evidence Applicants cite only the Reply Verified Statement of CP witness Bob Milloy (at pages 6-8), whose testimony is identified as responsive only to KCS, and who says nothing expressly about the issues AECC raised But (perhaps inadvertently) the data that Applicants provide through Mr Milloy (and others) actually validates, rather than refutes, AECC's concern

As described by Mr Milloy, and elsewhere in Applicants' filings, 8/ CP and UP have established cooperation via three so-called "Can-Am" routes

- The first Can-Am route involved upgrading interchange and cooperation between UP and CP for movements via Kingsgate, BC. According to information supplied by Applicants, this interchange is used by approximately 95 percent of the corn originated in the U S by CP (which moves to export markets via port facilities in the Pacific Northwest). 9/ This interchange is also used for significant volumes of [redacted] 10/ and fertilizers and forest products moving between western Canada and North Dakota on the one hand and the Pacific Northwest, California, the U S southwest and Mexico on the other hand 11/
- The "Midwest" Can-Am route (via St Paul, MN) carries industrial/chemical products, grain products and forest products moving between western Canada on the one hand and the central/south-central U S and Mexico on the other

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8/ See, for example, CPR-14 DME-14 (Public), Volume 1, Reply Verified Statement of Bob Milloy at pages 3-4

9/ CPR-14 DME-14 (Public), Volume 1, Reply Verified Statement of Don Smith (hereafter, "Reply VS Smith") at page 3

10/ CPR-14 DME-14 (Highly Confidential), Volume 2, Appendix B at page B-12

11/ CPR-14 DME-14 (Public), Volume 2, Appendix C at page C-2 hand. CP describes the past growth in traffic moved over this route as "very strong" 12/

- The "Eastern" Can-Am route (via Chicago) carries automotive, industrial products, forest products and intermodal traffic moving between eastern Canada and the northeastern U S on the one hand and the U S west, south and Mexico on the other hand 13/

In addition, CP moves traffic in joint-line service via BNSF involving [redacted] and other points

In the context of the proposed transaction, AECC's concern is that CP has more at stake in its interline relationships with UP and BNSF than does DME, and that UP and BNSF likely would not hesitate to withdraw their cooperation with CP if CP were to undertake the Project Both of these concerns have been corroborated by CP's own data and evidence

CP describes its line to the Kingsgate interchange with UP as [redacted] 14/ CP's density chart shows that as of 2005, this line handled in the range of 15-30 million gross tons (MGT) annually 15/ On an order of magnitude basis, even allowing for the inclusion of equipment weights in the MGT measure, this is

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12/ CPR-14 DME-14 (Public), Volume 2, Appendix C at page C-2

13/ CPR-14 DME-14 (Public), Volume 2, Appendix C at page C-2

14/ CPR-14 DME-14 (Highly Confidential), Volume 2, Appendix O at pages O-18-19

15/ See www8 cpr ca/cms/NR/rdonlyres/cpcwub5tmdw5ish7rtlbcvuitab7chn3uhhmsq3pccx63gh2t4atp5b4cdlzbovubvvr6pbcobvgqvcq7gkn5ssk4xa/Assets pdf comparable to the entire traffic base of DME 16/ Adding in the CP volumes moving over the other Can-Am routes and via BNSF, future expected growth in CP interline volumes associated with [redacted] 17/ the fact that CP has made significant infrastructure investments to increase the capacity and service associated with movements involving [redacted] 18/ and DME's limited interchange with the western railroads, there is no doubt regarding AECC's point that CP's exposure to possible retribution by the western railroads is much greater than that faced by DME

CP has also confirmed the reasonableness of AECC'c concerns that such retribution would occur, and described an additional method through which it could be implemented The general way new competitive initiatives can provoke non-cooperation by interline partners was explained in advice regarding CP relations with UP provided to CP management and witnesses by [redacted]

> [redacted] 19/

The critical importance of this concept in the context of the PRB Project was highlighted in the due diligence assessment of DME's grain business conducted by Applicant reply

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16/ For 2005, this is shown in CPR-DME-HC001532 to be [redacted]

17/ CPR-14 DME-14 (Highly Confidential), Volume 2, Appendix O at pages O-15-16

18/ See Section II B, above

19/ CPR-14 DME-14 (Highly Confidential), Volume 2, Appendix I at page I-16 In this context, [redacted].

witness Don Smith (CP's Senior Account Manager - U S Grain), which concluded as follows

> [redacted]
>
> [redacted] 20/

There can be no doubt that CP's management is keenly aware that pursuit of the Project would put at risk CP's substantial cooperative relationships with the western railroads, and that retribution associated with pursuit of the Project could extend beyond joint-line traffic into [redacted] Indeed, there appears to be a belief among some industry professionals that [redacted] 21/ Unless one is willing to assume that CP will recklessly disregard the risks of retribution, AECC's concerns have been fully validated

D The Contingent Payments Under The Agreement And Plan Of Merger Would Act As A "Poison Pill" To Discourage CP From Building The Project

In addition to the effect that building the PRB Project would have on CP's existing interline relationships with UP and BNSF, another reason why CP's acquisition of DME would make construction of the PRB Project less likely, if not impossible, is that

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20/ CPR-14 DME-14 (Highly Confidential), Volume 2, Appendix I at page I-9 Witness Smith's authorship of this document is established in Reply VS Smith at page 4

21/ CPR-14 DME-14 (Highly Confidential), Volume 2, Appendix Q at page Q-21 (transcript page 96)

CP would be required to pay "contingent payments" that could exceed $1 billion if it builds a line into the PRB, DME as an independent railroad today has the right to build the Project without paying ransom to anyone

Applicants blow off this concern with the cavalier assertion that the contingent payments "are not triggered until various economically valuable benchmarks are met" Applicants' Response at page 41 This is <u>false</u> The first (and largest) contingent payment -- $350 million -- would be triggered simply by starting to build the Project See Agreement and Plan of Merger, Section 3 05 (b), Exh 2 to the Application, Vol I, CPR-2 DME-2 CP would have to be very sure that the Project would be highly profitable before being willing to pay this huge entry fee into the PRB Given the constraints that the Project faces on achievable volume and yield, such a level of profitability would be highly unlikely at best, and would be further reduced by the contingency payments that CP would have to pay if it did achieve high traffic volumes

The accompanying Rebuttal Verified Statement of Michael A Nelson discusses in greater detail how the magnitude and structure of the contingency payments create a significant downward pressure on the likelihood that the Project, if otherwise viable, would ever be built

We do not know what the parties' intention was for including the contingent payment provisions in the Agreement and Plan of Merger, but their effect is clear they are a "poison pill" that would prevent CP from exercising the right, conferred by this Board on DME, to construct a line into the PRB

E <u>The Conditions Proposed By AECC Are Reasonable And Lawful</u>

The conditions proposed by AECC are narrowly tailored to address the problem that CP's acquisition of DME would cause with respect to new entry into the

PRB (We assume, without taking a position, that the Board will find that the acquisition is otherwise satisfactory.)

First, we propose a condition that would eliminate the "poison pill" contingent payments that virtually guarantee that CP could not build a line into the PRB This would still leave other impediments to the Project, including CP's relations with UP and BNSF, but there is nothing that the Board can do about them, unless and until they lead CP not to proceed with the Project

Second, we propose a series of conditions that would come into play only if CP did not decide to build the Project They are intended to address the fact that DME has acquired and is in the process of acquiring a substantial amount of land for the Project If the Project is not built, those land holdings would present a barrier to another entrant into the PRB AECC's conditions would make it possible to remove that barrier

Applicants claim that AECC's first condition, to disallow the contingent payments, would violate an alleged "well-established principle that the Board will not, in considering a proposed transaction, rewrite the underlying transaction documents" Applicants' Response at page 43. For this supposedly "well-established" rule, Applicants cite only a single case, St Louis Southwestern Ry – Purchase (Portion) – Gibbons, Trustee, 363 I C C 323 (1980), 1980 WL 14102 (I.C.C.) ("Tucumcari"), which does not even come close to supporting Applicants' argument

Tucumcari involved, among other transactions, the proposed assignment to the St Louis Southwestern Railway of a portion of the Chicago, Rock Island & Pacific Railroads's operating rights under an 1887 trackage rights agreement with Union Pacific UP objected to this assignment on the ground that the rights were not assignable, but the ICC rejected that argument In the alternative, UP argued that, if the agreement were assigned, it should be substantially reformed The ICC rejected that argument, too

The ICC observed that it had statutory authority to fix the terms and conditions of trackage rights agreements approved under former section 5(2)(a)(ii) of the Interstate Commerce Act, which was enacted in 1940, but this trackage rights agreement long predated that statute, so "we do not have jurisdiction to reform the terms of that agreement for the parties " Id at 367 Further, even if the ICC had jurisdiction to reform the agreement, "such reformation would not be warranted here" Id

Tucumcari has nothing to do with the issue in this case AECC is not asking the Board to "reform" an agreement, as UP asked in Tucumcari AECC is asking the Board to conclude that a particular provision of the Agreement and Plan or Merger – this "poison pill" provision – would have unacceptable anticompetitive effects, and to condition its approval of the transaction (if the Board finds it otherwise approvable) on the parties eliminating that provision Of course the Board has the authority under 49 U S C § 11324(c) to condition the transaction in this manner if the Board determines, as it should, that the public interest so demands

Applicants also argue that requiring CP to report to the Board by a date certain whether or not it will proceed with the Project is an "impermissible collateral attack" on the Board's prior approval Applicants' Response at page 43 This is not correct At the time CP announced its purchase of DME, CP's Fred Green told the press that it would probably take less than 36 months for CP to decide whether or not to proceed with the PRB Project 22/ The Board plainly has the authority to hold the

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22/ See www winonadailynews com/articles/2007/09/06/news/00lead txt merging carriers to their representations, and routinely does so when necessary to protect the public interest 23/ Applicants do not claim that CP will be unable to reach a decision by September 2009 If CP finds that it needs more time, and the Board agrees that this is reasonable, it can grant an extension of time 24/

Finally, Applicants argue that conditions requiring preservation for rail use and future divestiture of Project-related assets if the Project is not pursued would form "an impermissible ancillary attack" on the Board's prior approval of the PRB Project Applicants' Response at pages 43-44. Again, this contention is wrong because these conditions would only come into play if CP elects not to proceed with the Project, at that point, the Board's "approval" of the Project would become moot, and the question remaining would be what to do in the aftermath As discussed in AECC's Opposition at pages 8-10, under those circumstances the land that DME (and possibly CP) acquired for the purposes of the Project might actually block another party from building a third access into the PRB That clearly would be contrary to the public interest, which would benefit from additional rail capacity and competition for PRB coal transportation

Applicants argue that this Board lacks authority to address this problem, because DME has acquired this real estate under state laws Applicants' Response at pages 43-44 But that is precisely wrong DME was able to use state condemnation laws (or presumably negotiations under the threat of such laws) to acquire the land, because the Board had granted DME authority to build the Project If Applicants now decide not the build the Project, it would be a complete perversion of the public interest for them to

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23/ 49 U S C § 11324

24/ 49 U S C § 722(c)

use that land to block access by another party that wants to build a line into the PRB Applicants would have no basis for complaint if they are required to sell the land for fair market value to another party that wants to build a rail line into the PRB, in light of the fact that DME was able to force the prior owners of the land to sell it to DME because of DME's plan to build a rail line into the PRB

Therefore, if the Board approves this merger, it should condition that approval as proposed by AECC

III CONCLUSION

Construction of a new rail line into the Powder River Basin as proposed by DME and approved by the Board would benefit the public interest However, the obstacles to achieving those public benefits have proved to be substantial Acquisition of DME by CP through the proposed Agreement and Plan of Merger would create new obstacles and would make the construction of the Project substantially less likely CP is less than enthusiastic about the Project and has made no commitment to build it CP has not demonstrated in this record that its financial resources, line construction experience, or coal market involvement would enhance the Project's prospects CP would have to consider the effect of its undertaking the Project on its substantial existing business relations with its potential PRB competitors UP and BNSF CP would also have to consider that just to start construction of the Project it would have to make a $350 million contingent payment, with up to another $707 million required off the top if the Project generates substantial business

If the Board finds that the proposed CP/DME merger is generally satisfactory and should be approved, the Board should condition that approval so as to reduce the adverse effects of the merger on the Project The Applicants should be told that the transaction cannot be approved unless they remove the "poison pill" contingent payment provisions The Applicants should also be required to make a decision within a reasonable period of time whether or not to proceed with the Project If the Applicants decide not to build the Project, they should not be allowed to use the land they acquired for the Project to block someone else from building a new line into the Powder River Basin

Respectfully submitted,

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Dated May 19, 2008

REBUTTAL VERIFIED STATEMENT
OF
MICHAEL A. NELSON

1. Qualifications

My name is Michael A Nelson I am an independent transportation systems analyst with 28 years of experience in railroad competition and coal transportation My office is in Dalton, Massachusetts Prior to February 1984, I was a Senior Research Associate at Charles River Associates, an economic consulting firm in Boston, Massachusetts My qualifications were described in detail in the verified statement I submitted in Opposition Evidence And Argument And Request For Conditions Of Arkansas Electric Cooperative Corporation (AECC-3, dated March 4, 2008) ("AECC's Opposition")

2. Subjects Covered in This Statement

I have been asked by AECC to analyze and comment on Applicants' assertions made in reply to AECC's Opposition regarding the effects of the proposed transaction on DME's planned construction project to reach the Powder River Basin (PRB) (hereafter, "Project") Applicants assert that CP's "greater financial capability, its demonstrated expertise in designing and constructing new rail lines, and its extensive coal hauling experience will enhance – not detract from – DM&E's ongoing efforts to bring the PRB Project to fruition " [1]

[1] See Applicants' Response To Comments And Requests For Conditions And Rebuttal In Support Of Application (CPR-14 DME-14, dated April 18, 2008) ("Applicants' Response"), Volume 1 at page 41

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In order to "enhance" the "efforts to bring the PRB Project to fruition", the benefits CP is postulated to bring to the Project would necessarily have to outweigh the burdens imposed by CP's involvement As described in AECC's Opposition, these include the large contingency payments CP would owe if it undertakes the Project, and CP's interdependencies with UP and BNSF

AECC's Rebuttal comments address the inconsequential nature of the claimed benefits, and corroborate the substantial magnitude of the interdependencies This statement provides information regarding the magnitude of the impact of the contingency payments It then assesses the practical effects of the contingency payments in the context of the Project's limited ability to generate volume and contribution

3. Magnitude of Impact of Contingency Payments

As structured, the contingency payments associated with the proposed transaction take a project whose estimated economic cost is $3 billion, and ensure that it will not be constructed unless it can amortize an amount that exceeds that economic cost by an amount between $350 million and $1 057 billion (plus escalation).

The effects of these additional costs on Project finances can be seen in the following illustration. To ensure transparency, this illustration is simplified to avoid complications associated with ramping up assumptions, carrying costs during construction and other details that might be incorporated in a more formal financial analysis

Using the Board's most recent finding of a rail industry cost of capital of 9 94%, a $3 billion project with a risk profile and capital structure comparable to the industry average would prospectively have to yield sufficient contribution (above and beyond variable costs) to provide $298 2 million per year of debt service and return on equity If the Project were able to achieve an annual volume of 125 million tons, this equates to a required yield of approximately $2 39 for each ton moved Including the contingency payments, the required contribution would be $403 3 million per year This means if the Project were viable at the 125 million ton/$2 39 yield per ton level, it would nevertheless have to achieve a yield of over $3.22/ton (at the 125 million ton level) or a volume of over 168 million tons (at the $2 39 yield level) to be viable in the presence of the contingency payments

While CP correctly points out that the contingency payments are graduated, this does not materially alter the burden they would impose for any given volume Indeed, the $350 million initial fee applied to any volume up to 41 million tons poses a greater burden on each ton moved than would a $1 057 billion fee applied to 125 million tons Moreover, at lower volumes the project would have to achieve very high yields to be viable even without the without the contingency payments (i e , since the fixed costs would be borne by a smaller traffic base).

4. Practical Effects of Contingency Payments

To determine the practical effects of the contingency payments, it is necessary to consider the market environment in which they would be applied Hypothetically, for example, if the Project were operating in an environment in which it faced a sufficiently high and inelastic demand, the economics of the Project might permit CP to absorb the contingency payments without materially endangering the likelihood that the Project would proceed However, that is not the case here In this case, the constraints on potential volume and yield faced by the Project make it virtually certain that (a) absent the contingency payments, any decision by CP to proceed with the Project would be based on the thinnest of margins, and (b) inclusion of the contingency payments would essentially guarantee that the Project would not achieve economic viability

In the verified statement I submitted in AECC's Opposition, I provided an estimate that with CP involvement the Project would most likely be able to achieve an annual volume of 37 million tons The reasonableness of this figure is corroborated by several considerations. First, it reflects a share of approximately 38 percent of the total of approximately 98 million tons of Wyoming coal that is expected, based on DOE/EIA projections regularly used by the Board, to move to markets the Project is geographically oriented to serve This share is consistent with the fact that the Project would face direct competition from UP and BNSF on virtually all of the traffic it could serve, but would enjoy a mileage advantage over the incumbents for a portion of that traffic The reasonableness of the 37 million ton estimate is also corroborated by a somewhat lower estimate provided by the Project's original financial advisor, and by the fact that CP has provided no evidence or argument to the contrary

At 37 million tons, the Project would have to be able to generate a yield of approximately $8 06 per ton above variable costs from the highly competitive movements it would serve to provide the $298 9 million annual contribution required without the contingency payments (see Section 3, above) This is far above the competitive market yield of $0 28 per ton implied by the parameters that DME assumed and the Board endorsed in the original DME construction application for the Project [2] It is also far above the competitive market yield of $1 46 per ton suggested by data from the period preceding the PRB market disruptions that began in 2005 [3] Given that the introduction of a new competitor will introduce downward pressure on rates, and that the Project is designed to operate with a technology (115- to 135-car trains) that produces higher variable costs in comparison with the 150-car trains now being implemented by the incumbents, there is no reason for CP to expect that the Project could attain a yield materially higher than that enjoyed by UP and BNSF on competitive traffic As a result, the likelihood that future circumstances would support a rational decision to construct the Project construction is extremely small

At a volume of 37 million tons, only the milestone payment associated with initial Project construction ($350 million) would be payable Nevertheless, this payment would increase the required yield to approximately $333.0 million annually, or approximately $9 00 per ton Given that achievement of a yield of $8 06 per ton in the markets the Project could serve is at best a remote possibility, adding nearly $1 00 per ton to the required yield makes it virtually impossible With the economics of the Project already on life-support, the contingency payments form a "poison pill" which effectively guarantees that the Project would not achieve economic viability

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[2] As of 1998, the rate level resulting from UP/BNSF competition was asserted to be 8 25 mills per ton, premised on an asserted variable cost of 7 9-8 0 mills For a move of the 810-mile length provided by the Project, these parameters suggest an attainable yield of approximately $0 28/ton

[3] Based on the pre-2005 competitive rate level of approximately 7 5 mills per ton-mile indicated in a recent study conducted by the Congressional Research Service, and a variable cost level of approximately 5 7 mills per ton-mile found by the Board in rate reasonableness cases (with both figures predating or excluding recent fuel surcharges and price increases), an 810-mile movement in a competitive market would generate a contribution of approximately (810 x (0 0075-0 0057) =) $1 46 per ton

Hindering the ability of the Project to provide a competitive constraint on the exercise of market power by UP and BNSF may be consistent with CP's private interests stemming from its interdependencies with those carriers, but is plainly contrary to the public interest

VERIFICATION

I, Michael A. Nelson, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this verified statement.

Michael A. Nelson

Executed on May 14, 2008

CERTIFICATE OF SERVICE

I hereby certify that I have caused the foregoing Rebuttal In Support Of Request For Conditions By Arkansas Electric Cooperative Corporation, and supporting Rebuttal Verified Statement of Michael A Nelson, to be served by first class mail, postage prepaid, this 19th day of May 2008, on all parties of record and the following persons as specified in the Board's Decision dated December 27, 2007

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